(6)

No. 87-1097

In the Supreme Court of the United States

OCTOBER TERM, 1987

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, PETITIONER

v.

GEORGETOWN UNIVERSITY HOSPITAL, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF OF AMICI CURIAE SISTERS OF MERCY HEALTH CORPORATION AND MICHIGAN HOSPITAL ASSOCIATION

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QUESTIONS PRESENTED

A. Whether the Medicare Act forbids the Secretary of Health and Human Services from issuing a retroactive legislative rule in 1984 which purports to reduce Medicare reimbursement to providers for cost reporting periods of up to three years prior?

B. Whether the Administrative Procedure Act likewise forbids the Secretary from issuing such a retroactive legislative rule?

C. Whether the APA permits the Secretary, after his original prospectively promulgated rule was invalidated because of the failure to comply with the APA's notice and comment procedures, to reissue that identical legislative rule on a retroactive basis to cover the same period that the original unlawful rule would have covered, where the retroactive rule is not integral to fulfilling a statutory purpose?

D. Whether the 1984 retroactive rule satisfies the APA's notice and comment requirements where the Secretary had already determined to issue the rule, and the notice and comment period was a pro forma, post-hoc exercise engaged in simply to satisfy a court's scrutiny, rather than to permit the public to engage in effective, pre-decisional participation in rulemaking?

PARTIES TO THE PROCEEDING AND STATEMENT OF INTEREST

Leila Hospital and Health Center ("Leila") is a division of Sisters of Mercy Health Corporation, a Michigan nonprofit corporation d/b/a Leila Hospital and Health Center. Leila is a community hospital located in Battle Creek, Calhoun County, Michigan. The unlawful retroactive rule of the Secretary ("Secretary") of the United States Department of Health and Human Services ("HHS") will unfairly reduce Leila's Medicare reimbursement by more than $2 Million Dollars.

MHA is a trade association whose members are virtually all of the hospitals in the State of Michigan. The Michigan hospitals are concerned that this Court not adopt positions advocated by the Secretary, which could permit wholesale retroactive changes in the methods of determining Medicare reimbursement.

Both the Secretary, and Respondents have stipulated to the filing of this amici curiae brief. Amici file this Brief in support of Respondents.

The decision below is *Georgetown University Hospital, et al.* v *Bowen*, 821 F.2d 750 (D.C. Cir. 1987). This case is virtually identical to a case now pending before the Sixth Circuit Court of Appeals, *Leila Hospital and Health Center* v. *Bowen*, 661 F.Supp. 394 (W.D. Mich. 1987) and 661 F.Supp. 397 (W.D. Mich. 1987), *appeal docketed*, No. 87-1202, where the district court upheld the validity of the 1984 retroactive Wage Index, as applied to Leila Hospital.

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STATEMENT

This case is one of a series of cases involving a concerted effort by the Secretary to attempt, by issuing retroactive rules, to avoid the consequences of his failure to abide by the Administrative Procedure Act. The retroactive rule issued in this case purports to affect Medicare providers' reimbursement for periods of up to three years prior. If accepted, the Secretary's actions will undermine the integrity of the APA and throw the law of Medicare reimbursement into confusion and create an administrative morass.

The Secretary's pattern of folding layer upon layer of administrative procedure in an attempt to undo his original unlawful acts cannot be sanctioned. Only an unambiguous ruling by this Court will cause the Secretary to cease his cavalier treatment of APA rulemaking requirements.

Section 223(a) of the Social Security Amendments of 1972 amended the definition of reasonable cost for routine services so as to reimburse providers only for "the cost actually incurred, excluding therefrom any part of incurred cost found to be unnecessary in the efficient delivery of needed health services." Social Security Act § 1861x(v)(1)(A); 42 U.S.C.A. § 1395x(v)(1)(A).

In implementing Section 223, the Secretary elected to promulgate regulations setting forth reimbursement limits. The Secretary has calculated the Section 223 limits each year since 1976, 42 C.F.R. § 413.30(a), and then published in the Federal Register the schedule establishing the Section 223 limits for the upcoming year. Under the Section 223 limits, the Secretary reimburses providers the lesser of the provider's allowable costs or the Section 223 limits established for the provider. No hospital provider receives more than its actual costs for medical services. Indeed, the Secretary has never claimed in either this case or in the Sixth Circuit case, *Leila Hospital*, *supra*, that any hospital provider has received more than its costs.

Since 1979, the Secretary has calculated these limits based on labor and non-labor portions. The Secretary has computed

the labor portion using a wage index based on Bureau of Labor Statistics (BLS) data reflecting regional differences in hospital wages. 44 Fed. Reg. 31,806, 807 (1979).

The wage index is equal to the ratio of the average monthly wages of hospital employees for a specific area, usually the Standard Metropolitan Statistical Area ("SMSA"), to the national average monthly wages of hospital employees. The Secretary then multiplies the wage index by a standard base limit for labor costs to obtain the labor cost component of the Section 223 limits for each area.

In calculating the 1979 Wage Index and 1979 schedule of limits, the Secretary included wage data for both federal and non-federal hospital employees in both the regional and national BLS wage figures. The 1980 Wage Index also used the data for all hospital employees and the same general methodology used in the 1979 index. 45 Fed. Reg. 41,868 (1980). In promulgating the 1976-1980 schedules of limits, the Secretary complied with the notice and comment requirements of the APA.

Providers located close to federal hospitals are in direct competition for labor with such hospitals, and cannot effectively compete with these federal hospitals for employees without offering comparable wage and benefit packages. Yet, in 1981, the Secretary purported to issue a rule excluding all federal hospital wage data from the wage index. The 1981 Wage Index thus ignored providers' competition with federal hospitals.

Under the Secretary's 1981 Wage Index rule, Medicare reimbursement would be calculated as if nearby federal hospitals did not exist or did not have an impact on wages. Although some providers could not effectively compete with nearby federal hospitals for employees without offering comparable wages, the 1981 Wage Index ignored this fact, and caused some providers to be under-reimbursed.

The Secretary issued the new 1981 Wage Index without prior notice, without providing for public comments, and with an immediate effective date. 46 Fed. Reg. 33,637 (1981).

Although the Secretary claimed that "good cause" existed for dispensing with APA notice and comment requirements on the theory that the 1981 schedule of limits was developed "by using the same methodology" as in the 1980 schedule of limits, this was obviously false, since, unlike in previous years, federal hospital wage data was now excluded.

The Secretary did acknowledge elsewhere that he had changed the method used to calculate the 1981 Wage Index by "exclud[ing] data from federal government hospitals," 46 Fed. Reg. at 33,639, but the Secretary characterized the change as a "minor technical chang[e]." *Id.* at 33,639.

The Secretary's "minor technical change" resulted in hundreds of thousands of dollars in unreimbursed Medicare costs to hospitals such as Leila.

On April 29, 1983, the United States District Court for the District of Columbia determined in *District of Columbia Hospital Ass'n* v. *Heckler ("DCHA")*, Medicaid and Medicare Guide (CCH) ¶32,871 (D.D.C. April 29, 1983) that the 1981 Wage Index was invalid because the Secretary failed to comply with the notice and comment requirements of the APA, 5 U.S.C. § 553. The *DCHA* court found the Secretary's rationale for failing to comply with the APA's notice and comment requirements "the stuff of which arbitrary and capricious decisions are made." *DCHA*, at p. 9368. The court specifically rejected the Secretary's contention that "good cause" existed for dispensing with required APA notice and comment procedures. The Secretary did not appeal.

The Secretary responded to the invalidation of this rule quickly and methodically. First, the Secretary promulgated a notice announcing the court's decision invalidating the rule. 48 Fed. Reg. 39,998 (1983). Next, on February 17, 1984, the Secretary "reissue[d] for public comment" the methodological change which excluded federal hospital data from the data used to calculate the 1981 Wage Index. 49 Fed. Reg. 6175 (1984). Then, on November 26, 1984, the Secretary issued a final notice (the 1984 Wage Index) reissuing the same 1981 schedule of limits, *on an entirely retroactive basis to cover the same period of time that the 1981 Wage Index rule would*

have covered had it not been invalidated. 49 Fed. Reg. 46,495 (1984). The 1984 Rule was entirely retroactive because it applied only to reporting periods in the past. Thus, after the Secretary improperly issued the 1981 Wage Index rule without notice or comment, and after the *DCHA* court invalidated that rule, the Secretary purported to issue—over two years later—the same rule to cover the same period of time, on an entirely retroactive basis.

SUMMARY OF ARGUMENT

The Secretary's actions cannot stand for several independent reasons. First, the legislative history of the Medicare Act prohibits retroactive application of § 223 cost limit rules, including wage indices, which are components of § 223 cost limits. Express legislative intent shows that cost limit regulations must have prospective effect only. As the court below explained, when Congress passed the amendment authorizing promulgation of § 223 cost limit rules, "both Houses of Congress made clear their intent that this new authority was to be exercised on a prospective basis only." 821 F.2d at 758. Further, the retroactive corrective adjustments provision, 42 USC § 1395x(v)(1)(A)(ii), relied on after-the-fact by the Secretary, does not authorize the Secretary to promulgate general rules of retroactive application, such as the 1984 Wage Index.

Second, the express language and legislative history of the APA demonstrate that retroactive application of legislative rules such as the 1984 Wage Index is not permitted.

Third, the promulgation of a retroactive rule was not permitted because the Secretary was attempting to escape the consequences of his original illegal conduct (issuance of the 1981 Wage Index without complying with the APA) and because the retroactive rule was not essential to fulfill a statutory purpose.

Finally, the Secretary again violated the notice and comment requirements in issuing the 1984 Wage Index. As demonstrated unequivocally below, the Secretary had already made up his mind to issue the 1984 Wage Index, and the notice and

comment afforded was not effective, pre-decisional notice and comment. It was a post-hoc, proforma charade to satisfy a court's scrutiny.

The 1984 Wage Index represents a unique departure from the Secretary's prior course of conduct during the entire period of time in which the Medicare Act has been in effect. The Medicare Act, passed in 1965, requires that the Secretary promulgate numerous regulations defining Medicare reimbursement to providers. The Secretary has always engaged in prospective rulemaking, with only limited departures clearly distinguished in this brief. The 1984 Wage Index constitutes the first (but not last) instance in which the Secretary promulgated a regulation with a lengthy, and exclusive, retroactive effect. Furthermore, the Secretary's 1984 Wage Index rule would retroactively replace an identical rule previously invalidated on the basis that it was arbitrary and capricious. If upheld, the Secretary's actions would undermine the integrity of the rulemaking procedure and violate due process.

The Secretary repeated his administrative abuses in connection with his 1986 rule governing the apportionment of malpractice costs. The Secretary issued the 1986 rule to "cure" his 1979 malpractice rule after a multitude of courts invalidated his 1979 rule and ordered payment under the preexisting rule. All nine courts which have addressed the issue have held sternly and unequivocally that the Secretary may not apply the 1986 malpractice rule retroactively. *See Mason General Hospital* v. *Secretary of Department of Health and Human Services*, 809 F.2d 1220 (6th Cir. 1987); *Tallahassee Memorial Regional Medical Center* v. *Bowen*, 815 F.2d 1435 (11th Cir. 1987); *St. Peter's Medical Center* v. *Heckler*, 813 F.2d 398 (3d Cir. 1987); *Albany General Hospital* v. *Heckler*, 657 F.Supp. 87 (D. Ore. 1987); Miami General Hospital v. *Bowen*, 652 F.Supp. 812 (S.D. Fla. 1986); *West Anaheim Community Hospital* v. *Bowen*, CCH Medicare and Medicaid Guide ¶36,609 (C.D. Cal. July 13, 1987); *St. Joseph's Hospital* v. *Bowen*, CCH Medicare and Medicaid Guide ¶36,437 (D. Ariz. April 15, 1987); *Bethesda Community Hospital* v. *Heckler*, CCH Medicare and Medicaid Guide ¶36,654 (S.D.N.Y. Aug. 5, 1987);

Children's Hospital of San Francisco v. *Bowen*, CCH Medicare and Medicaid Guide ¶36,679 (E.D. Cal. Sep. 3, 1987).

This Court should repeat the stern admonition being given to the Secretary that his flouting of APA requirements will not be tolerated. His apparent philosophy that APA rulemaking requirements are simply so much baggage that can be avoided at will by issuing retroactive rules and engaging in post-hoc, pro forma notice and comment exercises is unacceptable and should not be countenanced.

ARGUMENT

I.

The Medicare Act Prohibits Retroactive Application of The 1984 Wage Index

A. Legislative History And Prior Agency Practice Confirm This Result

Legislation and therefore, *a fortiori*, a regulation, is not given retroactive effect "unless such be 'the unequivocal and inflexible import of the [statutory] terms, and the manifest intention of the legislature.'" *Greene* v. *United States*, 376 U.S. 149, 160, 11 L. Ed. 2d 576, 84 S.Ct. 615 (1964) (quoting *Union Pacific Railroad* v. *Laramie Stock Yards Co.*, 231 U.S. 190, 199, 58 L.Ed. 179, 34 S.Ct. 101 (1913)). *See also Brimstone Railroad and Canal Co.* v. *United States*, 276 U.S. 104,122 (1928) ("The power [of an agency] to require readjustments for the past is drastic. . . . It ought not to be extended so as to permit unreasonably harsh action *without very plain words*.") (Emphasis added.)

There are no "plain words" in the Medicare Act authorizing the Secretary to issue the 1984 Wage Index retroactively. In fact, the plain words show that the power to issue retroactive legislative rules was not granted to the Secretary. Section 223(b) authorizes the Secretary to establish limits on hospital costs "*to be recognized* as reasonable. . . ." (Emphasis added.)

This section requires the Secretary to establish the limits *before* the period begins to which they will apply.

Further, the legislative history of § 223 provides:

> [The authority] to set limits on costs . . . would be exercised on a prospective, rather than retrospective, basis . . . . *Senate Report* at 188; *House Report* at 83, *reprinted in* 1972 U.S. Cong. Code & Admin. News at 5070.

The court below emphasized that "both Houses of Congress made clear their intent that this new authority was to be exercised on a *prospective basis only*." 821 F.2d at 758 (emphasis added). *At the very least*, the power to issue retroactive rules—especially a rule such as the 1984 Wage Index having entirely retroactive effect—is not *conferred* in "unequivocal" or "plain" words. Consequently, the Secretary has no authority to retroactively apply the 1984 Wage Index.

Moreover, the Secretary himself has, until recently, recognized the prospective nature of § 223 cost limit rules, and that the 1984 Wage Index is a § 223 cost limit rule which accordingly is to be applied prospectively. As noted by the court in *Mason, supra:*

> The Secretary's own regulation regarding the limits on cost reimbursements states that "*[p]rior to the beginning of a cost period to which revised limits will be applied*, HCFA [Health Care Financing Administration] will publish a notice in the Federal Register, establishing cost limits and explaining the basis on which they were calculated." 809 F.2d at 1224 (emphasis in original).

The Secretary has consistently identified wage indices as § 223 cost limits to be applied prospectively. *See* 48 Fed. Reg. 39998 (September 2, 1983), 46 Fed. Reg. 48010 (September 30, 1981); and 46 Fed. Reg. 33637 (June 30, 1981). In the proposed notice of rulemaking for the 1984 Wage Index, for example, the Secretary stated in the background section:

> Section 1861(v)(1) of the Social Security Act (42 U.S.C. 1395x(v)(1)) as amended by Section 223 of Pub. L. 92-603, the Social Security Amendments of 1972, authorizes

the Secretary to set *prospective limits* on the costs that are reimbursed under Medicare. 49 Fed. Reg. at 6176 (emphasis added).

Without question, the authority provided to the Secretary by § 223 may be applied prospectively only. Even the Secretary has recognized this in the above public pronouncements, which the Secretary cannot now disavow. The court below aptly commented that "In light of the clear Congressional intent, and the uninterrupted agency practice, *we are astonished that the Secretary now purports to have the authority to promulgate such rules on a retroactive basis.*" 821 F.2d at 759 (emphasis added). By retroactively applying the 1984 Wage Index, the Secretary disrupted the statutory scheme created by Congress. The administrative decision to retroactively apply the 1984 Wage Index when previously the Secretary recognized that wage indices must be prospective is a radical departure from regulations and prior policy, is arbitrary and capricious, and is not permitted by the Medicare Act. The Secretary's action must be invalidated.

B. The Retroactive Corrective Adjustments Provision Does Not Authorize Retroactive Application of the 1984 Wage Index.

The Secretary's reliance on the retroactive corrective adjustments provision, 42 U.S.C. § 1395x(v)(1)(A)(ii),[1] for authorization of the retroactive application of the 1984 Wage Index is untenable. First, the Secretary did not even rely on this provision when he promulgated the 1984 Wage Index but rather issued the rule under § 223, which authorizes *prospective* cost-limit rules. The Secretary's post-hoc attempt to justify the rule under the retroactive corrective adjustments provision is impermissible, given the APA requirements that the Secretary provide notice of proposed rules which contains

[1] 42 U.S.C. § 1395x(v)(1)(A)(ii) provides that the Secretary may "provide for the making of suitable retroactive corrective adjustments where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive."

"reference to the legal authority under which the rule is proposed," 5 U.S.C. § 553(b)(2), and that final rules must be accompanied by "a concise general statement of their basis and purpose." 5 U.S.C. § 553(c).

In *Columbus & Southern Ohio Electric Co.* v. *Costle*, 638 F.2d 910 (6th Cir. 1980), the court invalidated an action of the Environmental Protection Agency ("EPA") for "EPA's failure to give a timely rationale." 638 F.2d at 912. The court explained:

> It is rather late in the development of administrative law to argue that an agency may offer *post hoc* bases for a prior decision. The judicial rule barring *post hoc* rationales for agency action applies to (informal) rulemaking as well as to agency adjudication. 638 F.2d at 912.

Moreover, there are numerous other reasons why the retroactive corrective adjustments provision cannot authorize retroactive application of the 1984 Wage Index. First, the legislative history of § 223 expressly provides that cost limit rules must be prospective—not retrospective. Section 223 was enacted subsequently to the enactment of the retroactive corrective adjustments provision. Therefore, whatever power existed under § 1395 to promulgate retroactive cost limit rules applicable across-the-board to all providers was superseded by the express mandate of § 223 that cost limit rules are to be prospective.

Second, the retroactive corrective *adjustments* provision does not authorize the Secretary to promulgate *general rules* of retroactive application such as the 1984 Wage Index. This provision merely empowers the Secretary to make retroactive corrective adjustments in the reimbursement of *particular providers* whose *aggregate* reimbursements are shown to be either "inadequate or excessive." The court in *West Anaheim, supra*, followed the *Georgetown* decision below, and found that the retroactive corrective adjustments provision authorizes "corrections, on an individual basis, but not rules of general application to be applied retroactively." *West Anaheim*, at 5.

The Secretary was not attempting to make a "retroactive corrective adjustment" with respect to the aggregate reimbursement received by "a provider of services," 42 U.S.C. § 1395(v)(1)(A) (ii). Rather, the Secretary was attempting to issue an across-the-board legislative rule applicable to all providers. As such, the 1984 Wage Index rule was not within the scope of § 1395.

Third, the retroactive corrective adjustments provision has never been interpreted to authorize truly retroactive rules, and could not authorize a legislative rule of exclusively retroactive effect such as the 1984 Wage Index. All of the cases which have allowed retroactive application of Medicare rules were cases which involved a regulation predominantly prospective in effect, which provided for recapture of accelerated depreciation. *See, e.g., Tennessee* v. *Califano*, 631 F.2d 89 (6th Cir. 1980); *Fairfax Nursing Center, Inc.* v. *Califano*, 590 F.2d 1297 (4th Cir. 1979); *Adams Nursing Home* v. *Mathews*, 548 F.2d 1077 (1st Cir. 1977); *Springdale Convalescent Center* v. *Mathews*, 545 F.2d 943 (5th Cir. 1977); *Hazelwood Clinic & Convalescent Hospital, Inc.* v. *Weinberger*, 543 F.2d 703 (9th Cir. 1976), *vacated and remanded on other grounds*, 430 U.S. 952, 51 L. Ed. 2d 801, 97 S.Ct. 1595 (1977).

Even the recapture regulation was predominantly *prospective* in nature "because it allowed a provider a six-month grace period after the regulation was promulgated to withdraw from the Medicare program and thereby retain the accelerated depreciation payments made to it." *Mason, supra*, 809 F.2d at 1226. The above recapture cases do not authorize retroactive promulgation of Medicare regulations generally. Only providers who *voluntarily* remained in the Medicare program after the grace period would be subject to the recapture. For this reason, the regulation was held to have "limited and reasonable" retroactive effects. *Hazelwood, supra*, 543 F.2d at 708. However, even this limited retroactive regulation was invalidated in part by the Third Circuit Court of Appeals, in *Daughters of Miriam Center for the Aged*, 590 F.2d 1250 (3d Cir. 1978), which held that retroactive application was beyond the statutory authority of the Secretary to the extent the drop in

utilization was beyond the control of the provider. In such circumstances, the court reasoned that retroactivity is not permissible where the provider did not have an opportunity to voluntarily avoid retroactive application of the regulation.

The court in *Daughters of Miriam* further noted significant congressional intent that the Medicare Act did not authorize the Secretary to promulgate regulations which would retroactively redefine the principles of reimbursement for a cost previously incurred by a provider.[2] In accord with this reasoning, the First Circuit Court of Appeals upheld the limited retroactivity of the recapture regulation as applied to providers who voluntarily terminated participation in the Medicare program, but stated that a regulation which redefined the method for determining the reasonable cost of a purchased item "would be far more troubling. . . ." *Adams Nursing Home* v. *Mathews*, 548 F.2d 1077, 1081 n.12 (1st Cir. 1977).

The 1984 Wage Index does *not* involve such a limited retroactivity or predominantly prospective application. It was intended to have exclusively retroactive application to cost periods already completed, and is not authorized by the Medicare Act. There are no cases which support the Secretary's contention that the retroactive corrective adjustments provision authorizes the entirely retroactive 1984 Wage Index.

In sum, any limited authority for retroactivity which the Secretary may have in *adjudications* under the retroactive corrective *adjustments* provision is irrelevant to the 1984 legislative Wage Index rule.

In addition to procedural invalidity, the 1984 Wage Index suffers from serious substantive defects. Although the *DCHA* trial court did not have cause to reach the substantive merits

[2] "It would hardly seem reasonable at the end of the year, after hospitals had entered into an agreement with you on the basis of certain principles, to shift all principles for retroactive settlement in terms of how you compute a cost. I don't think that was contemplated at all." (Quoting statement of Robert M. Ball, then Commissioner of Social Security). 590 F.2d at 1295, n. 23.

of the 1981 Wage Index, it recognized substantive difficulties. The court commented that the decision to exclude federal hospital data "was clearly a controversial one, and plaintiffs have demonstrated that the Secretary may have been unaware or even mistaken about some facts central to the decision." *DCHA*, at p. 9368. In a footnote to that statement, the court noted that "the defendants did not have a list before them of all federal government hospitals when deciding to exclude their wage data, thus making precise calculation of the fiscal impact difficult." *Id.*, at 9371, n.8. The court added that "defendants may have also erred in their assumption that federal government hospitals 'typically' set their wages according to 'national pay scales.'" *Id.*, at 9371, n.8.

The Secretary has never demonstrated the absence of a relationship between federal hospital and non-federal hospital wages which would justify exclusion of federal hospital data from wage indices. One commentator opined that "eliminating federal hospital wage data from calculation of the wage index will lower reimbursement to facilities located around the federal hospital." 49 Fed. Reg. at 46487. Obviously, a hospital proximately located to a federal government hospital must compete with the federal hospital for employees and should be reimbursed at levels calculated with reference to the wages paid at the federal hospital. Thus, a provider proximately located to a federal government hospital incurs reasonable costs when it competes for labor with that hospital. Yet, the 1984 Wage Index ignores such competition, a clear violation of the reasonable cost standard set forth in 42 U.S.C. § 1395x(v)(1)(A).

Thus, as shown above, the 1984 Wage Index violates the Medicare Act's requirement of *prospective* cost-limit rules, and it must be invalidated. Furthermore, as shown, the 1984 Wage Index rule is substantively flawed.

II.

Retroactive Application of the 1984 Wage Index is Prohibited by the Administrative Procedure Act.

The APA requires an agency promulgating a rule to (1) publish a proposed notice in the federal register, (2) provide an adequate "basis and purpose statement," and (3) invite,

and adequately respond to, public comments on the proposed notice, unless a specific exception to those requirements applies. 5 U.S.C.A. § 553.

In this case, it is uncontested that the Secretary failed to comply with these notice and comment requirements in initially promulgating a change in methodology for the 1981 Wage Index. The Secretary's attempted promulgation *in 1984* of the same 1981 Wage Index, *on a retroactive basis*, finds no support in the APA, and contravenes express language of the APA, past agency practice (see discussion, *supra*), and the Attorney General's own manual on procedure.

First, the APA defines a rule in pertinent part as "the whole or part of an agency statement of general or particular applicability and *future effect* . . . . and includes the approval or prescription *for the future* of rates, wages . . . ." 5 U.S.C. § 551(4) (emphasis added). Moreover, except in specified circumstances, the agency rule may not become effective until 30 days after the date of final publication. 5 U.S.C. § 553(d). Thus, under the express language of the APA, the 1984 Wage Index can have only future effect, not the retroactive effect it purports to have.

The Secretary argues that § 553(d)—which permits a rule to be effective less than 30 days in the future only if there is "good cause"—does not apply when the rule will "take effect" 30 days in the future, but will be entirely retroactive. This is ludicrous, and unsupported by the text of that section. The Secretary's theory is illogical because applying a rule with a lengthy *retroactive* application (which is to "take effect" 30 days in the future) is more onerous and drastic than a *prospective* rule effective less than 30 days after its issuance.

Accordingly, because the 1984 Wage Index is a legislative rule promulgated pursuant to APA rulemaking procedures, the 1984 rule must comply with the APA requirement that rulemaking be prospective. § 5 U.S.C. §§ 551(4), 553(d).

The United States Supreme Court has described the distinction between rulemakings and adjudications in *United States* v. *Florida East Coast Railway Co.*, 410 U.S. 224, 35 L. Ed. 2d 223, 93 S.Ct. 810 (1973):

> While the line dividing them may not always be a bright one, these decisions represent a recognized distinction in administrative law between proceedings for the purpose of promulgating policy-type rules or standards, on the one hand, and proceedings designed to adjudicate disputed facts and particular cases on the other. 410 U.S. at 245.

The court below correctly concluded that the 1984 Wage Index is a legislative rule. The 1984 Wage Index involves a legislative-type policy decision which does not single out a particular party or apply to a particular set of facts. That the Secretary promulgated the 1984 Wage Index through a notice and comment procedure in the Federal Register must be considered to concede that the 1984 Wage Index is a legislative rule.

In correctly determining that the APA did not sanction the Secretary's retroactive 1984 Wage Index rule, the court below explained that equitable considerations are irrelevant to this determination:

> The instant case does not in any way involve a new agency policy articulated in the course of adjudication. Rather, it involves a *legislative rule* adopted by the Secretary pursuant to the notice and comment procedures of the APA, 5 U.S.C. § 553 (1982). As recognized in *Retail Union* itself, the APA requires that legislative rules be given future effect only. Because of this clear statutory command, equitable considerations are irrelevant to the determination of whether the Secretary's rule may be applied retroactively; such retroactive application is foreclosed by the express terms of the APA. 821 F.2d at 757 (emphasis in original).

Consequently, the court correctly held that retroactive application of the 1984 Wage Index is barred by the APA.

This ruling is consistent with the Attorney General's interpretation of the APA, *i.e.*, that retroactive rulemaking is generally prohibited (unless there is a finding of "good cause"). § 553(d). The Attorney General's Committee on Administrative Procedure states that the issuance of retroactive rules

should be "accompanied by the finding required by section 4(c) [requiring good cause]." Attorney General's Manual 37.

This result is consistent with the recent decision of the United States District Court for the Central District of California, in *West Anaheim, supra*. There, the court invalidated the retroactive application of a Medicare reimbursement rule and expressly followed the *Georgetown* ruling below. The court stated that "the APA envisions only prospective application of general legislative rule making." Use of a balancing test is appropriate only in determining the validity of retroactive application of policies adopted *in the course of agency adjudications*. *See Securities and Exchange Commission* v. *Chenery Corp.*, 332 U.S. 194, 91 L.Ed. 1995, 67 S.Ct. 1575 (1947); *J.L. Foti Construction Co.* v. *Occupational Safety & Health Commission*, 687 F.2d 853 (6th Cir. 1982).

The court in *Retail, Wholesale & Department Store Union* v. *NLRB*, 466 F.2d 380 (D.C. Cir. 1972), stated that rules adopted pursuant to formal rulemaking proceedings "are prospective in application only," 466 F.2d at 383, and the United States Supreme Court in *Chenery* referred to "quasi-legislative promulgation of rules to be applied in the future." 332 U.S. at 202. Under these authorities, the 1984 Wage Index rule cannot be applied retroactively.

Related to the principle that the 1984 Wage Index may not be applied retroactively is the consistent holding of the courts that, upon invalidation of a Medicare reimbursement rule, the prior rule in effect is reinstated. *See, e.g., Cumberland Medical Center* v. *Secretary of Health & Human Services*, 781 F.2d 536 (6th Cir. 1986); *Mason General Hospital* v. *Secretary of Department of Health and Human Services*, 809 F.2d 1220 (6th Cir. 1987); *Abington Memorial Hospital* v. *Heckler*, 750 F2d 242, 244 (3rd Cir. 1984) *cert. denied*, 88 L. Ed. 2d 149, 106 S.Ct. 180 (1985). In *Cumberland*, the Sixth Circuit invalidated a Medicare reimbursement rule, stating that "we cannot accept the Secretary's argument that the prior regulation cannot be reinstated." 781 F.2d at 539. The court explained:

> The five circuit courts that have considered this issue or stated the relief to be granted have ordered reimburse-

ment under the prior regulation. The common rationale is that the current rule being invalid from its inception, the prior regulation is reinstated until validly rescinded or replaced. 781 F.2d at 538 (footnote omitted).

Likewise, the *Georgetown* D.C. court below explained:

> This circuit has previously held that the effect of invalidating an agency rule is to '*reinstat[e]* the rules previously in force.' *Action on Smoking & Health* v. *CAB*, 713 F.2d 795, 797 (D.C. Cir. 1983) (emphasis added); *accord Menorah Medical Center* v. *Heckler*, 768 F.2d 292, 297 (8th Cir. 1985); *Abington Memorial Hosp.* v. *Heckler*, 750 F.2d 242, 244 (3d Cir. 1984), *cert. denied*, 106 S.Ct. 180 (1985). Accordingly, when the District Court vacated the Secretary's *1981* wage-index rule, it necessarily reinstated the Secretary's *1979* rule, which required the Secretary to reimburse providers using a formula that included federal-hospital data . . . 821 F.2d at 757-58 (emphasis in original).

Allowing the Secretary to retroactively apply the invalidated rule allows the Secretary a "second chance" at lawful promulgation. *Cumberland*, 781 F.2d at 539. The gravity of the Secretary's action here is even greater than in *Cumberland* because the Secretary's attempt at this "second chance" is the result of invalidation of the prior rule for noncompliance with APA rulemaking requirements. Numerous cases decided within the past 18 months show that the Secretary's attempts to retroactively apply Medicare reimbursement rules in the face of prior illegal conduct by the Secretary have failed. *Tallahassee Memorial Regional Medical Center* v. *Bowen*, 815 F.2d 1435 (11th Cir. 1987); *West Anaheim Community Hospital* v. *Bowen*, No. 84-4452-WDK (C.D. Cal. July 16, 1987); *Albany General Hospital* v. *Heckler*, No. 83-851-FR, Medicaid and Medicare Guide (CCH) 36,289 (D.C. Ore. January 22, 1987); *Miami General Hospital* v. *Bowen*, 652 F. Supp. 812 (S.D. Fla. 1986); and *Mason General Hospital* v. *Department of Health and Human Services*, 809 F.2d 1220 (6th Cir. 1986).

This Court can and should repeat once again the stern and unwavering message being sent to the Secretary by the federal judiciary—that his attempt to avoid the consequences of issuing arbitrary and capricious rules by promulgating similar (or, in this case, identical) replacement rules with retroactive effect will not be countenanced. If a rule is invalid, the prior valid rule must remain in effect until replaced by a valid rule with *prospective* effect.

III.

The Secretary Cannot Show That Retroactive Application of the Wage Index Serves Statutory Interests.

Even in those cases where, *unlike here*, the particular agency does have some retroactive rulemaking authority, case law shows that such powers may not be wielded absent *compelling* circumstances. The Secretary cannot show the existence of such circumstances here to warrant his wielding of such an unusual power. In *Mobil Oil Corp.* v. *Department of Energy*, 678 F.2d 1083 (Temp. Emer. Ct. App. 1982), the court set forth standards to determine the validity of a rule promulgated retroactively, where the original rule had been invalidated.

Recognizing that rules are rarely applied retroactively, and that the authority to do so "is even more limited when the rule promulgated has previously been invalidated by a court," the court stated that the test is *stringent:*

> Was the 1981 repromulgation of the 1974 amendment necessary to fulfill a statutory design, or would the failure to give retroactive effect to the 1981 amendment "do violence to the law as Congress wrote it?"

678 F.2d at 1090.

The court in *Mobil Oil* determined that the Department of Energy did not meet its burden to apply regulations retroactively. The court emphasized that the Department did not show "a compelling reason to allow a retroactive repair," *id.*, *i.e.*, the likelihood of significant harm unless the rule was applied retroactively:

> Since the DOE has not shown that there will be a significant "mischief of producing a result contrary to a statutory design . . . ," we conclude that the retroactive repromulgation of the 1974 amendment is invalid. *Id.*

This analysis was also applied in the trial court below, where the court held that retroactive application of the 1984 Wage Index did not serve statutory interests.

Mason General, supra, is an especially apt case because the Secretary, as in this case, attempted to take a second bite at the apple by issuing a similar rule (seven years later) after the first rule had been invalidated. In *Cumberland,* the Secretary's 1979 Medicare Malpractice Rule (dealing with the amount of reimbursement a provider would receive for malpractice insurance) was declared invalid. Subsequently, as in this case, the Secretary in 1986 purported to reissue the rule (though in slightly modified form) for public comment, and then did issue the rule in final form *on a retroactive basis,* to the date of the 1979 Rule.

The *Mason* court held that the Secretary had very little authority to issue retroactive rules and that he had *no* authority to issue a retroactive rule in the case before it[1] because the rule was not integral to a statutory purpose:

> None of the parties to this case challenge the fact that the determination of reimbursable costs under the Medicare Act involves "substantive" rulemaking by the agency, and as such, must be issued in conformity with the pro-

[1]The *Mason* court applied the following factors:

1. the degree of capriciousness or abuse of discretion exhibited by the agency in the promulgation of the initial rule;
2. the existence and duration of a prior settled regulation or practice, and the extent to which the initial invalidated rule constituted a substantial change in such settled practice; and,
3. the extent to which the change embodied in the initial invalidated rule was integral to the effectuation of the statutory purpose. (809 F.2d at 1228.)

cedures set forth in the APA. However, agencies are also empowered to issue "interpretive" rules pursuant to the quasi-judicial process of hearings conducted in individual cases. Generally, such quasi-judicial rulemaking is accorded deference by the courts in view of the necessity that an agency be capable of responding with flexibility to unforeseeable specialized problems as they arise. See *SEC* v. *Chenery Corp.*, 332 U.S. 194, 202-03, 67 S.Ct. 1575, 1580, 91 L.Ed. 1995 (1947) (upholding retroactive clarification of uncertain law through adjudication). The Supreme Court in *Chenery* also admonished, however, that since an agency has "the ability to make new law prospectively through the exercise of its rulemaking powers, . . . [t]he function of filling in the interstices of the Act should be performed, as much as possible, through this quasi-legislative promulgation of rules *to be applied in the future.*" Id. at 202, 67 S.Ct. at 1580 (emphasis added). As aptly noted by K.C. Davis in his Administrative Law Treatise:

> A basic distinction must be recognized between (1) new applications of law, clarifications, and additions, and (2) substitution of new law for old law that was reasonably clear. The first is natural, normal, and necessary. The second raises problems of fairness to those who have relied on the old law.

Id., 20:7 at 23 (1983). Therefore, we note that an agency attempting to promulgate a rule pursuant to APA procedures bears a heavy burden to justifying retroactivity in view of the Act's goal of assuring that new rules be of prospective application only.

* * * *

> Based on the foregoing, we cannot find that the change which the Secretary attempted to impose via the 1979 Rule was essential to the effectuation of the statutory purpose. 829 F.2d at 1224-25, 1230.

Likewise here, this case does not constitute the special circumstances required before such authority may be exercised. Importantly, the *Mason* court also stated that "In the proper

case, it may also be appropriate to consider both the existence or degree of any appearance of agency abuse of discretion in the procedural promulgation of a replacement rule and the extent to which the repromulgated rule differs substantively from the invalidated rule. . . ." 809 F.2d at 1231, n.9. These factors likewise militate in favor of invalidation of the 1984 Wage Index.

The changes embodied in the 1981 Wage Index and 1984 Wage Index were not necessary to effectuate statutory purposes or to fill a regulatory gap. The Secretary would have excluded such data from the *1979 Wage Index* if the exclusion were integral to statutory purposes. Furthermore, the Secretary did not implement this change when he made adjustments to the first wage index in 1980. 45 Fed. Reg. 41868 (June 20, 1980). Moreover, the change in the 1981 Wage Index was *contrary* to the statutory purpose because the wage index fails to take into account major competitors of providers.

Indeed, the view that "wages paid by a federal hospital do not reflect the local economy since federal wages are based primarily on national pay scales," 49 Fed. Reg. at 46497, a view held by the Secretary, is not the result of a study but is rather an unsupported "belief" (49 Fed. Reg. at 46497) and a "theory" (49 Fed. Reg. at 46498). An agency rule is invalid if it is based on a study which does not support the rule's premises. *Walter O. Boswell Memorial Hospital* v. *Heckler*, 749 F.2d 788, 803 (D.C. Cir. 1984); *Almay, Inc.* v. *Califano*, 569 F.2d 674, 682 (D.C. Cir. 1977); *Cumberland Medical Center, supra*, (Medicare reimbursement rule invalidated). Because both the 1981 and the 1984 Wage Index were the product of a mere "belief" on the part of the Secretary without any substantiation or verification, they are invalid. *Id.*

The Secretary has stated, contradictorily, that the exclusion of federal hospital data is a "minor technical chang[e]." 46 Fed. Reg. at 33,638, 639. In the final notice on November 26, 1984, the Secretary responded to a comment using the same rationale: "We consider the change that was made to the wage index a *minor technical change*." 49 Fed. Reg. at 46, 498 (emphasis added). Yet, immediately preceding this response,

the Secretary stated "[e]ven though only a limited number of hospitals are adversely affected by the exclusion of Federal hospital wage data, *a significant* amount of Medicare reimbursement is involved for each individual hospital that is affected," *Id.* at 46,497 (emphasis added), demonstrating contradictory reasoning. *See also Id.* at 46,497 ("we are not causing any undue hardship"); 49 Fed. Reg. at 6,177 (reissuance "would impose only a minimal burden on a few hospitals").

As noted by the district court in *DCHA:*

> Moreover, defendants are caught in contradiction when they leap from a description of the wage index change as "minor" to their argument that notice and comment would have been "contrary to the public interest." Defendants argue that the change in the formula was so insignificant that it produced only a "very limited . . . small impact." Points and Authorities, *supra*, at 21-22. Yet they also argue that the public interest justified acting without awaiting public participation because the new schedule would save the public money and protect against "windfalls" totaling "hundreds of thousands of dollars." This contradictory rationale is the stuff of which arbitrary and capricious decisions are made. [*DCHA*, *supra*, at p. 9368.]

Because the changes implemented by the 1984 Wage Index were not essential to the effectuation of a statutory purpose, the 1984 Wage Index fails to meet the standards of compelling circumstances to justify retroactivity.

IV.
The Secretary Again Violated APA's Notice and Comment Requirements.

The Secretary's 1984 rule is invalid for his failure to afford legitimate notice and comment before issuing the rule.

On February 17, 1984, the Secretary issued a proposed notice in the Federal Register requesting public comment on the 1984 Wage Index. 49 Fed. Reg. 6175. The Secretary received public comment and purported to reply to the comment, but—as

demonstrated below—he had already made up his mind to issue the rule, and no amount of "public comment" could change his mind. The Secretary next published the 1984 Wage Index as originally calculated, with retroactive effect to 1981. 49 Fed. Reg. 46,495. The Secretary's after-the-fact, pro forma provision for public notice and comment does not comply with the APA. If permitted, the Secretary's charade would eviscerate the mandate of effective, pre-decisional, public participation in rulemaking and would render the APA's notice and comment requirements a nullity.

Case law makes it clear that post-promulgation notice and comment is invalid. For example, in *United States Steel Corp.* v. *United States Environmental Protection Agency*, 595 F.2d 207, *reh'g granted*, 598 F.2d 915 (5th Cir. 1979), the court rejected the United States Environmental Protection Agency argument that the agency's acceptance of post-promulgation comments with an "open mind" satisfied the APA:

> Section 553 is designed to ensure that affected parties have an opportunity to participate in and influence agency decision making at an early stage, when the agency is more likely to give real consideration to alternative ideas. Other courts have recognized this difference and rejected arguments similar to that asserted here:
>
> > Permitting the submission of views after the effective date is no substitute for the right of interested persons to make their views known to the agency in time to influence the rule making process in a meaningful way . . . "We doubt that persons would bother to submit their views or that the Secretary would seriously consider their suggestions after the regulations are a *fait accompli*."
>
> *Id.* at 214-15 (quoting extensive authority), *quoted in New Jersey* v. *United States Environmental Protection Agency*, 626 F.2d. 1038, 1049-50 (D.C. Cir. 1980); *accord, Sharon Steel Corp.* v. *Environmental Protection Agency*, 597 F.2d 377, 381 (3rd Cir. 1979). The *United States Steel* court also recognized that:

> Were we to allow the EPA to prevail on this point [that the EPA might cure a failure to give prior notice and comment on a rule by providing for notice and comment after promulgation] we would make the provisions of § 553 virtually unenforceable. An agency that wished to dispense with pre-promulgation notice and comment could simply do so, invite post-promulgation comment, and republish the regulation before a reviewing court could act.

595 F.2d at 215.

As in *United States Steel*, the Secretary cannot comply with the APA by providing for after-the-fact public notice and comment as was done here. Soliciting comments after the agency had already made up its mind does not comply with the APA, and is a mockery of the rulemaking process.

In *South Carolina ex rel. Patrick* v. *Block*, 558 F. Supp. 1004, 1006 (D.S.C. 1983), the Secretary of Agriculture determined to require "a deduction of 50 cents per hundredweight from proceeds of sales of all milk marketed commercially in the United States." The Secretary of Agriculture provided for notice and public comment only on the implementation of the determination. The court rejected the Secretary of Agriculture's contention that he had substantially complied with the APA by soliciting after-the-fact comments on the implementation plan.

In holding the Secretary's actions invalid, the court stated: "The Final Rule shows that the deduction was an accomplished fact from the outset. There is nothing to indicate that anything that was said or that could have been said by way of comment would have swayed the Secretary in his determination to impose the deduction." *Id.* at 1010. The court also held:

> The record is clear. I find that the Secretary set his mind very early on that he would impose the deduction. *There were no procedures by which interested persons would have an input into this decision comparable to that which is required by 5 U.S.C. § 553.* Accordingly, I find that the public was given no opportunity for meaningful

comment on whether the Secretary would impose the fifty cents per hundredweight deduction before he made his decision.

Even assuming that the Secretary was of an open mind after he issued the Notice of Determination of September 24, *the cases make clear that the allowance of post hoc comment is no substitute for the right to comment on a proposed rule before the administrator makes his decision*. The purpose of the notice and comment requirement of 5 U.S.C. § 553 is to allow interested parties to voice their views before a rule comes into effect, when there is greater likelihood that the administrator or agency will be receptive to information and argument. *In the long run, to permit agencies to resort to post facto comment would allow them to negate at will the Congressional decision that notice and the opportunity to comment must precede decision, and would deprive parties of all effective means to enforce the rights granted by this section.*

Id. at 1020-21 (emphasis added).

As in *South Carolina ex rel. Patrick*, the Secretary never provided the public with the opportunity to influence the decision to exclude federal hospital data. The Secretary had already decided, prior to soliciting public comment, to apply the same methodology the *DCHA* court had invalidated. *Indeed, over a month before the Secretary issued the notice to reissue the 1981 Wage Index for public comment, the Secretary issued a final rule to implement PPS, 49 Fed. Reg. 234 (1984) which rejected several public comments "object[ing] to the continued exclusion of (BLS) wage and employment records from Federal hospitals to derive the wage index."* *Id.* at 257. The Secretary stated there that: "continuing to exclude Federal hospital statistics from the BLS data used to construct the wage index *is appropriate*." *Id.* at 258 (emphasis added).

Thus, the Secretary purported to request comments on a wage index methodology *that the Secretary had already determined to apply*. No amount of public comments could have changed the Secretary's mind about using federal hospital data in a similar wage index. The notice and comment

procedure was a charade, and constituted a clear violation of effective, pre-decisional notice and comment participation.

In fact, the very language that the Secretary used in issuing the rule for "comment" demonstrates that the Secretary was not seriously considering the appropriateness of the decision. The Secretary was merely attempting to satisfy a court's scrutiny. The February 17, 1984 proposed notice stated "*We are reissuing for public comment* the change in the types of data that were used to calculate the [1981] wage index." 49 Fed. Reg. at 6175 (emphasis added). The November 26, 1984 final notice stated even more clearly the Secretary's limited purpose in the proposed notice. "The February 17, 1984, proposed notice *was intended to remedy the rulemaking deficiencies perceived by the District Court and to validate* use of the 1981 schedule of hospital cost limits by bringing the wage index contained in the 1981 schedule of limits into compliance with the APA." 49 Fed. Reg. at 46,496 (emphasis added).

Later, the Secretary used more tell-tale language: "By issuing a proposed notice and final notice, *we are correcting a procedural defect* of not soliciting public comments *before making a change in methodology*." *Id.* at 46,497 (emphasis added). The Secretary further stated: "By republishing the same wage index at this time, *we are correcting the procedural defect perceived by the court;* that is, the failure to provide a *comment period*." *Id.* at 46,498 (emphasis added).

As amply demonstrated, and as determined by the court below, the Secretary decided *in 1981* to calculate the 1981 Wage Index without using federal hospital data. The Secretary's reissuance of the same 1981 Wage Index in 1984 for public comment was solely an attempt to satisfy a court's scrutiny and not to reconsider that decision. As such, this post-hoc, pro forma process does not satisfy the APA's requirement for meaningful, pre-decisional public participation in the administrative process, and must be rejected.

CONCLUSION

For the foregoing reasons, the decision of the D.C. Court of Appeals should be affirmed.

Respectfully submitted,

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